STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE ENROLLED BILL ANALYSIS

Date Amended:	**Enrolled**	Bill No:	**SB 808**
Tax:	**Sales and Use**	Author:	**Karnette**
Board Position:		Related Bills:	

BILL SUMMARY

This bill would reinstate the sales and use tax exemption for fuel and petroleum products (bunker fuel) sold to water common carriers.

ANALYSIS

Current Law

Under current law, sales of fuel and petroleum products to water common carriers are subject to tax.

Proposed Law

This bill would repeal and replace Section 6385 of the Sales and Use Tax Law to include a sales and use tax exemption for sales of fuel and petroleum products (bunker fuel) sold to water common carriers for immediate shipment outside this state for consumption in conduct of its business as a common carrier after the first out-of-state destination. The proposed exemption would require a water common carrier to only pay tax on the fuel needed to get from California to its first out-of-state destination. This bill would also require the Legislative Analyst Office to submit a report on December 31, 2005 to the Governor and the Legislature that evaluates the economic impact of the sales tax exemption for bunker fuel. The proposed exemption would become operative on the first day of the first calendar quarter commencing more than 90 days after the effective date and would sunset as of January 1, 2014. This bill would also reinstate the existing Section 6385 without the sales and use tax exemption for bunker fuel as of January 1, 2014.

Background

Until July 15, 1991, sales of fuel and petroleum products to water, air, and rail common carriers were exempt from tax when used in the conduct of the carrier's common carrier activities after the first out-of-state destination. The exemption for bunker fuel purchased by qualified waterborne vessels was dependent upon the amount of bunker fuel on board the vessel prior to refueling. If the quantity of bunker fuel on board the vessel on arrival at the California port was sufficient to enable the vessel to reach its first out-of-state destination, then the bunker fuel loaded at the California port would have been entirely exempt from tax. However, if the quantity of bunker fuel needed on the voyage from the California port to the first out-of-state destination and the amount used while in port exceeded the quantity of fuel on board the vessel on arrival at the California port, the amount of that excess was subject to tax. The exemption was repealed in 1991 by AB 2181 (Ch. 85, 1991) and SB 179 (Ch. 88, 1991).

As a result of the loss of the exemption, the Pacific Merchant Shipping Association sponsored AB 2396 (Ch. 905, 1992) to combat what they claimed was a disastrous tax law change. They argued that the repeal of the exemption for water common carriers resulted in a decline in the number of ships which bunker in California ports. The re-establishment of the exemption was designed to increase bunker activity in California.

Beginning January 1, 1993, as amended by Section 1.5 of Chapter 905 of 1992, Section 6385 once again granted an exemption for bunker fuel for certain uses. That measure, however, contained a sunset provision which would have repealed the exemption on January 1, 1998. Assembly Bill 366 (Ch. 615, 1997) extended the sunset provision until January 1, 2003, and also required the Legislative Analyst's Office (LAO) to study the effects of the bunker fuel exemption and prepare a report of their findings.

The LAO issued their report in 2002 on the effect of the bunker fuel exemption, and concluded "On this tax policy basis, we recommend that the Legislature remove the existing sunset for the current partial (sales and use tax) exemption for bunker fuel sales, and make the exemption permanent. This would result in the (sales and use tax) being levied in the future only on the portion of the fuel purchased in California which is consumed between California and the first out-of-state destination. This action would result in treating bunker fuel sales similarly to other export sales and place California ports on par with other U.S. out-of-state ports." The Pacific Merchant Shipping Association sponsored Senate Bill 145 (Perata) during the 2002 Legislative Session to extend the sunset date for the bunker fuel exemption until January 1, 2013. SB 145 passed the Legislature, but was vetoed by the Governor. The Governor's veto message included the following statement:

"While I would ordinarily sign this measure, the state's very difficult financial condition requires me to veto this bill because it would result in total state and local revenue losses in the range of $22.3 to $33.5 million depending on the consumption of bunker fuel. In the current fiscal environment, enacting a measure with such losses would not be prudent."

As a result of the Governor's veto of SB 145, the sales and use tax exemption for sales of bunker fuel sunset as of January 1, 2003.

COMMENTS

1. **Sponsor and Purpose.** According to the author's office, this bill is sponsored by the Pacific Merchant Shipping Association and the International Long Shore Workers Union. The purpose of this bill is to reinstate the sales and use tax exemption for bunker fuel that was repealed as of January 1, 2003.

2. **Summary of amendments.** Previous versions of this bill contained provisions unrelated to any of the tax and fee programs administered by the Board. **September 8** amendments deleted all the previous provisions of the bill and inserted the provisions to reinstate the sales and use tax exemption for sales of bunker fuel. **September 11** amendments added the provision requiring the Legislative Analyst's Office to submit a report to the Governor and the Legislature at the end of 2005.

3. **Sales tax law for air and rail common carriers.** Section 6357.5 of the Sales and Use Tax Law contains an exemption for fuel sold to an air common carrier for immediate consumption or shipment in the conduct of its business on an international flight. Fuel purchased for domestic flights is not included in the exemption.

   Fuel sold to rail common carriers remains subject to the sales tax.

4. **Report to the Legislature.** This bill would require the Legislative Analyst's Office to submit a report on December 31, 2005 to the Governor and the Legislature that evaluates the economic impact of the sales tax exemption for bunker fuel. Although the proposed exemption would not expire until the January 1, 2014, the Legislature is requesting the report at the end of 2005 so they may evaluate the economic impact of the exemption, and pursue legislation to repeal the exemption prior to 2014 if necessary.

5. **The Board does not foresee any administrative problems with this measure.** Reinstating the sales and use tax exemption for sales of fuel and petroleum products to water common carriers as proposed by this measure could be easily administered by the Board.

COST ESTIMATE

Some costs would be incurred in revising publications and notifying the public and Board staff. These costs would be minor.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

The United States Energy Information Administration reports that sales of bunker fuel in California during 2001 amounted to 1,434,934,000 gallons. Since there are 42 gallons to a barrel of bunker fuel, sales of bunker fuel in barrels amounted to 34.2 million barrels. The California Energy Commission reports that the average price per barrel for bunker fuel sold in California was $27.85 during the month of August 2003. Total annual sales of bunker fuel are estimated to be $952.5 million. (34.2 million barrels x $27.85 per barrel = $952.5 million.)

A portion of these sales will remain taxable as it is used prior to the first out-of-state destination. In a study done by Price Waterhouse for the Pacific Merchant Shipping Association (PMSA), it was estimated that 12% of bunker fuel is used prior to the first out-of-state destination. If we apply this percentage to the $952.5 million in sales, $114.3 million in sales of bunker fuel will remain subject to the sales and use tax. The remaining $838.2 million in sales will be exempt from the sales and use under the provisions of this bill.

The exemption for bunker fuel used after the first out-of-state destination was repealed as of January 1, 2003. Bunker fuel sales for 2003 have declined significantly. Information from the LA/Long Beach Ports shows the following bunker fuel sales:

Barrels Delivered

Month	2002	2003	% Change
January	1,918,361	1,891,135	- 1.4%
February	1,900,412	1,105,617	- 41.8%
March	2,056,821	1,899,320	- 7.7%
April	1,877,387	1,657,963	- 11.7%
May	2,115,742	1,812,078	- 14.4%
June	2,099,680	1,496,072	- 28.7%
July	1,557,029	1,119,302	- 28.1%
Total	13,525,342	10,981,487	- 18.8%

Total bunker fuel sales for August are not yet known, however, Long Beach reports that their operation bunker fuel sales for August 2003 declined by 46% from August 2002.

According to the PMSA, bunker fuel sales in California for March, April and May were higher than expected due to a number of reasons, such as the Iraqi war and a strike in Venezuela that reduced bunker fuel supplies at the Panama Canal. They feel that the declines in February, June, July and August are more representative of the long-term effects of the repeal of the exemption.

Based on information from the LA/Long Beach Port and PMSA, bunker fuel sales are estimated to decline from between 40% and 60%. Therefore, the sales of bunker fuel that would be subject to the sales and use tax, if the exemption is not reinstated, are estimated to be between $335.3 million and $502.9 million. ($838.2 million x 40% = $335.3 million; $838.2 million x 60% = $502.9 million.)

Revenue Summary

The revenue impact from exempting from the sales and use tax fuel and petroleum products sold to a water common carrier, for immediate shipment outside this state for consumption in the conduct of its business as a common carrier after the first out of state destination would be as follows:

		Revenue Effect		
Fuel & Petroleum Sales	between	$ 335.3 million	and	$ 502.9 million
State loss (5%)	between	$ 16.8 million	and	$ 25.1 million
Local loss (2.25%)	between	7.5 million	and	11.3 million
Transit loss (1%)*	between	3.4 million	and	5.0 million
Total	between	$ 27.7 million	and	$ 41.4 million

* Nearly all of the bunker fuel is sold in jurisdictions with a tax rate of 8.25%.

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